L. R. B. & M. JOURNAL

VOLUME 12 NUMBER 3
MAY, 1931

Published by
LYBRAND, ROSS BROS. & MONTGOMERY
Accountants and Auditors

L. R. B. & M. JOURNAL

VOLUME TWELVE | MAY, 1931 | NUMBER THREE

Some Observations on the Business and Accounts of a Cotton Merchant

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(Dallas Office)

In conformity with changing business conditions in general, the cotton merchant's business has been subjected to many changes during the past two decades. In the majority of instances, these changes have been occasioned, either by conditions arising during and after the Great War of 1914 to 1918, or by conditions brought about by governmental regulation of trade practices or by governmental attempts to control or coerce the normal functioning of economic laws.

Without becoming involved in a discussion as to the merits or demerits of governmental activities as affecting a business, which for so great a number of years has been of vital importance in the economic life of the United States and particularly of the southern states, it should be of interest to note some of the more important changes that have arisen in the cotton merchant's business since pre-war years.

Aspects of Business

In considering various aspects of the cotton merchant's business, it is proposed to discuss certain of the activities of those whose business, in the chain of marketing the cotton crop from the cotton farmer to the cotton spinner, is that of the first actual wholesale dealer in the commodity. Some firms so engaged designated themselves "spot cotton merchants", others "cotton buyers and shippers", while the function of each is that of a middleman who purchases the cotton farmers' crop for the purpose of sale to domestic spinners or foreign buyers or spinners.

The cotton merchant's business involves the purchase of cotton from numerous cotton growers, country merchants, "street buyers" and cotton factors, often over an extended territory. The cotton thus bought is generally purchased during a few months in the year, namely August to January, and must be concentrated and stored in compresses or warehouses until the proper time for shipment to the merchant's customers arrives. As the cotton crop moves during a few months in the year, and as the requirements of the cotton merchant's customers, as to shipment, are more evenly spread through the year, the merchant must be prepared to hold his cotton purchases in stock for some period, relieving the grower of that necessity, and providing for the domestic spinner or foreign buyer a market to which he may come to obtain his requirements of cotton, concentrated in suitable localities and properly classified as to "grade" and "staple". Briefly then, the cotton merchant's business is one of accumulation and classification of the cotton crop for the benefit of the cotton spinner or foreign buyer, and the holding of the crop, as an in-

termediary between the grower and the fabricator of the commodity, providing the former with a more immediate cash market for his produce, and serving the latter with a more convenient buying market.

The risks attendant on such a business, are apparent, especially in recent years when, in the first place, the price of cotton has suffered wide fluctuations and, in the second place, governmental activities have created elements of uncertainty, not capable of being estimated by a consideration of supply and demand or of the many other factors which must be weighed carefully in the formulation of a sound view of the cotton situation.

The various methods in use by the cotton merchant in attempting to limit risks arising from the first noted conditions will be touched upon; the limitation of risks arising from the second noted conditions may not be possible in the face of the exercise of a superior, but not necessarily a more intelligent, power.

One of the outstanding features, in the changes in the cotton merchant's business, is the increased need of capital for the proper conduct of business and the maintenance of activities which combine that of a merchant with many of those of a banker and a broker.

Prior to the Great War, cotton was strictly a cash commodity, involving few technicalities of marketing and with limited indirect obligations. Cotton was bought and sold at a fixed price, the greater volume of the business was for prompt shipment and the protective operation of hedging for the foreign buyer was undertaken by that buyer himself. The shipper simply drew, with a full set of documents, on New York or London banks, and sold his bills through the acceptance trade, either at sight, sixty or ninety days.

Evidence of the change in the relative importance of the United States cotton crop to the world's crop and the decrease in relative volume of United States cotton exports may be seen from the undernoted figures. In the season 1911-1912, seventy percent of the world's cotton crop was produced in the United States, and of this, more than seventy-five percent was sold to foreign countries. In the season 1929-1930 the world's production of cotton amounted to 26,733,000 bales of which the United States produced 14,716,000 bales or fifty-five percent of the total, and exported 6,697,000 bales or forty-five percent of the American crop to foreign countries.

Terms Used

In connection with the consideration of the business and accounts of a cotton merchant, there are certain terms used by the cotton merchant which demand at least some brief explanation. These terms are as follows:

"Hedges"—One definition of the verb "to hedge", as given in Webster's dictionary, is stated as "to safeguard one's self from loss on a bet or speculation by making compensatory arrangements on the other side". A hedge, as the term is used in the cotton business, is a counterbalancing transaction, under which a given quantity of cotton is either purchased or sold at a fixed price in order to offset the sale or purchase of a certain number of bales of cotton at a fixed price. Hedging is the means by which a cotton merchant endeavors to limit his risk in the purchase and sale of cotton, and keep from being an outright gam-

bler in the commodity. The cotton merchant uses the medium of the cotton "futures" market for the purpose of passing on some portion of his market risks either to others who have opposite risks in the market or to the speculator in general. When a cotton merchant buys actual cotton and does not sell it immediately, he sells futures to protect himself against a decline in price; and when a merchant sells actual cotton and does not buy it immediately he buys futures to protect himself against an advance in price. The transactions undertaken in "futures", namely contracts for the future delivery of cotton, are made through a broker, a member of one of the three organized exchanges in New York, Liverpool or New Orleans, or of the Chicago Board of Trade. Hedging has been defined as a method of trade insurance, whereby the cotton merchant can limit his risks from market fluctuations. Combining actual cotton and contracts for the future delivery of cotton, the merchant is enabled to maintain a balance between the total of his sales and the total of his purchases.

"Forward Sale"—The term "forward sale" is used to designate a valid and enforceable contract covering the sale by the cotton merchant of a certain number of bales of cotton for shipment at a specified time.

"Forward Purchase" — The term "forward purchase" is used to designate a valid and enforceable contract under which the cotton merchant contracts to buy a certain number of bales of cotton for delivery to him at a specified time.

"On Call"—The term "on call" is used to qualify a forward sale or a forward purchase when such contract is not definite as to the price to be paid for the cotton involved in the contract. When the price to be paid for the cotton is a definite price per pound, the contract is termed "fixed". The buyer of cotton, whether it be the cotton merchant, the spinner or the European buyer, may desire to avoid the hedging of certain contracts; this he may do by buying his cotton "on call". The contract will then be made for the delivery of cotton with the price per pound to be paid, being specified as a certain number of points "off" or "on" a given future month's price as quoted on the day the price is "fixed" or "called" on such one of recognized cotton exchanges as is specified. In determining the price of cotton or of futures, "one point" is equal to one hundredth of a cent, and "one Liverpool point" is equal to one hundredth of an English penny.

"Basis"—The term "basis" is used to designate the relation of the price of actual cotton to the price of future contracts. If actual cotton is sold at a higher price than the futures contract, it is said to be sold at a "premium" and if actual cotton is sold at a lower price than the futures contract, it is said to be sold at a "discount". Cotton sold at a premium is said to be sold at so many points "on" the future month specified, and cotton sold at a discount is said to be sold at so many points "off" the future month specified. When actual cotton and the futures contract, with which comparison is being made, are being sold at the same price, then the price of the actual cotton is said to be "even" with the futures contract. Various elements enter into the consideration of basis. In the first place, there is the premium

which the price for delivery of actual cotton, all of the given character contemplated in the sales contract, should bear above the price for the contract for future delivery, on which many grades may be tendered. Next, there is the cost of delivery of the cotton at the point of destination specified in the sales contract, and in addition there is the merchant's cost of operating his business and the profit he expects to make on the sale. Basis is also affected by the supply and demand with respect to the various grades and staples of cotton being traded in, in any given season, and at the various times during the season.

It will be observed, that while the cotton merchant, through his hedging transactions, may limit his risk with respect to market fluctuations, the machinery of the future market does not provide him with a means of hedging in respect of basis fluctuations. It is not possible to trade in actual cotton and not have the relation between the price of the actual cotton and the price of futures widen out or narrow with the varying conditions of the market.

"Position"—The cotton merchant's use of the machinery of the future market is to hedge his purchases and sales of actual cotton. In so doing, the merchant may be long of actual cotton and short of futures or he may be short of actual cotton and long of futures. In the first case the merchant is said to be "long of the basis" and in the second case he is said to be "short of the basis". The situation of the merchant with respect to these elements is termed his "position". The various elements which must be considered in establishing the merchant's "position" will include one or more of the following:

Long

(1) Inventory of cotton on hand
(2) Provisional shipments (i. e., cotton shipped "on call")
(3) Fixed forward purchases
(4) Long hedges
(5) Unfixed forward purchases (i. e., call purchases not received

Short

(6) Fixed forward sales
(7) Provisional purchases (i. e., cotton received "on call")
(8) Short hedges
(9) Unfixed forward sales (i. e., call sales not shipped)

In the foregoing, items numbered (1) to (4) inclusive and (6) to (8) inclusive are offset to determine the merchant's market position, and the items numbered (1), (3), and (5) on the long side are offset against the items numbered (6) and (9) on the short side to determine the merchant's position with respect to basis.

"Grade"—The term "grade" as applied to cotton is used to designate the character of the cotton with respect to its color and the amount of impurities, such as pieces of broken leaf, contained in the cotton.

"Staple"—The term "staple" as applied to cotton is used to designate the character of the cotton with respect to the length and strength of its fibres.

In prior years the standards for "grade" and "staple", against which export sales were made and arbitrated, were those established in Liverpool, Bremen and Havre, and the requirements of each of these markets being different, the United States exporter had an excellent outlet for his average purchases. Prior to the war, claims on shippers for "grade" and

"staple" differences were not of great significance and the arbitration differences were narrow and the fluctuations between the season's highest price and lowest price were moderate.

The practice of "on call" buying and selling, which has grown to such an extent in post-war years, is responsible for many of the changes in the marketing of cotton during recent years. This practice has placed a larger burden of financing on the cotton merchants and has obliged them to carry, not only their own hedges, but also the spinners' or foreign buyers' hedges, often until the cotton has passed into manufactured goods.

For quite some time, financing has been extended by the cotton merchant until the cotton has been delivered at its final destination. Such reimbursement terms as "cash on arrival of cotton at port of destination"; "cash in —— days after arrival of steamer carrying the cotton"; or drafts at thirty, sixty, ninety and one hundred and eighty days sight from date of arrival of steamer are part of the routine of the present financing of cotton sales.

All of these financial transactions and changes in procedure place the cotton merchant, especially the one with limited capital, in an uncomfortable situation. Failure or inability on the part of the cotton merchant to secure adequate and sufficiently elastic credit cooperation from his banker may be very embarrassing, when confronted with the necessity of extended "hedging" operations or repeated margin calls consequent on market fluctuations.

As a result of the practice of "on call" buying and selling, a new risk has arisen for the cotton merchant in the difference which exists between the provisional invoice price, namely the price at which the "on call" cotton is shipped, and the final invoice price, ascertained at the time the price of the "on call" cotton is fixed. This difference is a cash item and is subject to immediate settlement at the time the price is fixed. However, the credit risk exists, as the shipper may have no longer any security in the cotton shipped, and market fluctuations may have caused the difference between the provisional and final invoice price to be to the credit of the shipper in a material sum.

The selling and arbitration of cotton with respect to "grade" and "staple" as affecting the United States cotton merchant is undertaken in terms of standards established by the United States Government, and foreign cotton markets have accepted these standards, as affecting shipments from the United States. In accordance with these standards, arbitration with respect to staple lengths is based on inches. Enropean merchants continue to effect sales on millimeter description, whereas the United States shipper, if not selling on inch description sells on "type" or on "actual samples".

Inasmuch as in pre-war years, and even for a number of years thereafter, cotton merchants were dealing, in the main, with cash transactions, the accounting records and classification of accounts in use by such merchants were simple. Simple cash receipt and cash disbursement records were considered adequate and the general ledger seldom contained more accounts than were necessary to record cash and bank accounts, cotton purchases and

cotton sales, and such few expense accounts as salaries, traveling expenses, telephone, telegraph and cable charges, freight, insurance and compress charges, and the accounts recording the firm's capital and surplus or proprietorship accounts.

Some merchants were even more conservative in their use of accounts and used an account which was the final resting place for the record of purchases, sales and almost every other character of item connected with the purchase or sale of cotton. The "Cotton Account", as this receptacle for heterogeneous entries was termed, may still be found in the accounts of some few cotton merchants. Then, one is confronted with an account to which debits for purchases, sales rejections, weight and class claims on sales, compress charges, freight charges, bank discounts and other dissimilar charges are made. The credits to such an account may contain, in addition to sales items, credits for claims on the country seller of cotton, for freight and insurance refunds, and even for settlements on account of "on call" purchases.

In present times, the complexity of the cotton merchant's business, and his function as merchant, banker, broker and credit grantor demand a more detailed system of accounts. Additionally, while in previous years, a somewhat generous margin of profit, accruing to the cotton merchant, might excuse a very broadminded view of the accounting records necessary, in these times, the narrowing margin of profit and increasing competition requires a detailed accounting for day to day operations as well as an adequate analysis of the final profit or loss for the season.

Coincident with the growing need of the cotton merchant for a more exact accounting system, the accountants of the South, where the majority of the cotton merchants' offices are situated, were going through a process of education. Consequently, it is now possible to find cases where both the accountant and the cotton merchant are in substantial agreement as to the character of accounting system necessary and the proper consideration of the various elements which enter into the balance sheet of a cotton merchant.

Records in Use

A brief review of the various records and accounts in use in the accounting systems of a cotton merchant, with particular reference to certain special accounts, follows:

The records in which financial transactions are recorded are as follows:

(1) *General ledger,* in customary form, in which the various accounts are maintained, for the purpose of recording the assets, liabilities, income and expense accounts.

(2) *Cash Receipts Book,* which provides sufficient columns for the entry of transactions with the various banks with which the merchant has an active business, and for the entry of cotton sales, collections on trade accounts, collections on claims in connection with the purchase of cotton, collections on freight refunds, and with a general column for miscellaneous or infrequent receipts.

(3) *Cash Disbursements Book,* which provides columns for the entry of transactions with the merchant's various bankers and for the entry of

cotton purchases, payments on trade accounts, freight charges, compress and handling charges, payments on claims in connection with the purchase of cotton, charges for patching, charges for salaries and office expenses, charges for buying expenses, and with a general ledger column for the entry of other disbursements.

(4) *A Journal* provided with sufficient debit and credit columns to record entries to trade accounts, for the recording of sales not the subject of immediate cash reimbursement, for sales claims, for the entry of profits or losses on closed "hedge" transactions, and for the entry of charges for selling commissions, sales charges, and with a general ledger column for the entry of items for which provision has not been made otherwise.

(5) *A subsidiary ledger, in which are recorded the accounts with trade debtors and creditors,* under the control of the trade ledger control account in the general ledger.

(6) *A subsidiary ledger, in which are recorded the amounts due to or by the merchant on account of claims in connection with purchases of cotton.* This ledger is generally designated the "Outturn Ledger" and is often not under the control of an account in the general ledger. It is advisable, however, that the "outturn ledger" be kept under control by means of the posting to a general ledger account of the claims due to and by the merchant, as entered in a special column in the journal, and the liquidation of these claims as shown by the entries in the appropriate columns in the cash records.

In all records, in which entries are made for sales or purchases of cotton, special columns are provided for the recording of the number of bales involved in each transaction, as it is essential that the bale account be kept in balance with the inventory of cotton on hand. The record of bales, in connection with each transaction or group of transactions, should also be made when postings are made to the general ledger or to the trade ledger.

Among other records maintained by the cotton merchant are the following:

(1) *Purchase Record.* This record, which may be either a bound book or in loose leaf form, contains the necessary information as to the merchant's commitments for the purchase of cotton, giving the seller's name, point of origin of the cotton, number of bales bought, terms of purchase, date the cotton is due to be shipped with a record of the receipt of the cotton and the date of fixation of the price and the final price of the cotton if the cotton has been purchased "on call".

(2) *Sales Record.* This record, either in bound or in loose leaf form contains the necessary information as to the merchant's commitments for the sale of cotton. This record gives the name and address of the buyer of the cotton, the number of bales sold, point to which shipment is to be made, date shipment is due to be made, terms of sale, broker through whom sale is made with rate of commission due to broker, date shipment is made, and the date of fixation of the price and the final price of the cotton if the cotton has been sold "on call". Further information, recorded against each shipment made includes the number of the invoice covering the shipment, the "mark" or shipping designation,

with the number of bales and weight of cotton shipped, date of shipment, the weight outturn as reported on arrival of the cotton at destination and the outturn with respect to claims for weight and for grade and staple as finally settled with the purchaser of the cotton.

(3) *Stock Record.* This record is used for the purpose of listing the bales of cotton received by the merchant, under the appropriate identification or shipping "mark", entry being made by bale numbers. Record is made of the disposition of the individual bales as they are applied against shipments.

(4) *Future Position Record.* This record, which is termed the "Position Book" or the "Long and Short Book", is used for the purpose of recording the merchant's commitments under the contracts of purchase and sale of actual or "spot cotton", and his commitments in connection with "futures" or protective contracts for the future delivery of cotton. This record, maintained from day to day, showing the daily transactions with respect to purchases and sales of spot cotton, whether at a fixed price or "on call", as well as the daily transactions with respect to "futures", is the record used by the cotton merchant to indicate to him his "position" in the cotton market both as to "market position" and "basis position".

(5) *Foreign Exchange Record.* This record is used for the purpose of recording the merchant's commitments in respect of his sales of foreign currency and the application thereagainst of foreign currency receipts arising from sales invoices on which the reimbursement is not in United States currency.

(6) *Sales Invoice Book.* This record, often maintained in sections according to the general territories to which sales are being made, such as "Continental Sales", "Liverpool Sales" or "Domestic Sales", is kept in memorandum form. This record contains the original or pencil draft of the sales invoice to be made out covering each shipment and is used as a posting medium for charges to trade customers on sales against which reimbursement is not immediate, and as a checking medium against cash receipts on sales with immediate reimbursement.

(7) *Other records* in use are those for the purpose of showing the location of the inventory of cotton on hand in accordance with the compresses and warehouses in which the cotton may be stored from time to time, and for the purpose of showing the number of bales of cotton pledged as security against obligations to banks. In the case of some merchants, a subsidiary ledger is maintained for the purpose of charging disbursements for interior freight bills against accounts designated for various railroads at various points of origin. The application to these accounts of receipts on account of concentration refunds received from railroads, and the proper entry of adjustments for differentials in rates, serves to account for the proper handling of concentration claims. Various other statistical records are maintained by many merchants for the purpose of providing general and particular information desired by the merchant in the conduct of his business.

Financial Statements

Balance Sheet: A typical balance sheet of a cotton merchant will show the following accounts:

Assets:

Current:

- Cash in banks and on hand
- Documents in transit ———B/c
- Acceptances receivable
- Accounts receivable:
  - Brokers
  - Trade
- Current claims on railroads and others
- Market differences on open transactions
- Inventory of cotton at market value ———B/c

Investments:

- Stocks of corporations
- Membership in cotton exchanges

Fixed assets:

- Furniture, fixtures and automobiles, less provision for depreciation

Other assets:

Deferred charges:

- Prepaid interest and other expenses

Liabilities:

Current:

- Acceptances payable, banks
- Advances by banks
- Accounts payable:
  - Brokers
  - Trade
- Accrued claims payable
- Accrued cotton charges and commissions
- Accrued expenses
- Market differences on open transactions
- Federal income tax

Capital:

- Capital stock
- Surplus

Income Account: A typical income account of a cotton merchant will contain the following accounts:

Sales-Gross.	═══B/c	$	
Add, or deduct hedges		———	$
Less, Sales deductions:			
Freight		$	
Insurance			
Discount on drafts			
Patching			
Sales commissions			
Claims for weight			
Claims for grade and staple			
Sales charges			
		———	———
			$
Cost of sales:			
Inventory at beginning of season	———B/c		
Purchases	———B/c		
Country outturns			
Compress and handling charges			
Buying commissions	———B/c	———	
		$	
Less, Inventory at close of season	———B/c	———	
	B/c		
	═══		———
Gross profit on sales			$

Sales of loose and pickings			
Gross income from cotton			$
Expenses:			
Salaries:			
Officers	$		
Employees		$	
Interest	$		
Exchange			
Traveling expense			
Telephone, telegraph and cables			
Exchange and association dues			
Office and general expenses			
Net income from cotton			$
Other income or expense:			
Interest received		$	
Dividends received			
Previous season's items			
Foreign exchange adjustments			
Net income from operations			$

Having set out, in brief, the records in daily use in the cotton merchant's business, certain accounts more or less peculiar to the typical balance sheet of a cotton merchant will be discussed.

Unless one is considering the balance sheet at the close of a season, say at June 30th or July 31st, when almost complete liquidation may have been effected with respect to the inventory of actual cotton and of obligations on future transactions, these items will be of the greatest significance in setting up the merchant's balance sheet and assessing the results of operations for the season.

In brief, the valuations which are used in preparing the balance sheet of a cotton merchant place the merchant's inventory and all elements of his future position, i. e. his open contracts for actual cotton or futures, on a liquidating basis as of the date of the balance sheet, based on the published market quotations.

When one considers the cotton merchant's method of doing business and his operations during a cotton season, in an endeavor to protect himself against market fluctuations, involving the covering of spot cotton purchases by the sale of hedges and the covering of fixed forward sales by the purchase of hedges, it is seen to be impossible to determine the final cost of a given bale of cotton on hand in the inventory.

It will be observed that the typical balance sheet, shown previously, indicates that the inventory of cotton is to be shown at market value and that provision is made for taking into account what is termed "market differences on open transactions."

Valuation of Cotton Inventory

In the valuation of the cotton inventory, due regard is given to the weight, the grade and the staple of the various bales of cotton identified as being on hand. With respect to the market value of the cotton for the various grades and staples, most merchants base the valuations on the nearest ac-

tive future month in relation to which cotton is being bought and sold at the date of the balance sheet. Thus if the balance sheet is being prepared as at July 31st, cotton valuations will be based "on" or "off" the October futures contract.

Consideration is also given to the location of the cotton, as cotton at the port or in European warehouses is relatively more valuable than that at interior points, as the merchant has already made disbursements for freight and handling charges.

The identification of the grade and staple of the cotton as shown in the inventory must be made from the merchant's regularly maintained records of bales classified as to grade and staple and may be checked further by reference to the samples remaining in the merchant's sample room in connection with the cotton on hand. Further evidence may be obtained from a consideration of sales subsequent to the date of the balance sheet.

The basic valuation in respect of the future month is obtained from the published quotations, while the variations for the grades and staples must be ascertained by reference to the prevailing quotations in the market territory where the cotton is situated.

Inasmuch as the above noted method of valuation involves the weighing of opinion as to "basis", possibly in a locality where the persons concerned in the issuance of "basis" differences may be unduly optimistic or unduly pessimistic, or where an insufficient volume of trading at the moment causes the rendering of a sound opinion difficult, it is felt that the really consistent and conservative method of valuation of an inventory of cotton at market is to value the inventory, insofar as is possible, by reference to delivery on a futures contract.

Such a valuation of a cotton inventory, insofar as the grades and staples on hand acceptable as tenderable on a futures contract are concerned, is considered to give a true liquidation value. The valuations of such portions of the inventory as are not tenderable, if sufficiently near to tenderable cotton in grade and staple, may be made to conform to the tender price with suitable adjustment for grade and staple differences. Inferior cotton may be valued with reference to tender price with such discounts taken as to insure conservative valuations.

The advantage of using valuations based upon tendering cotton, giving due consideration to the cost of tendering and the cost of carrying the cotton until the month of tender, and the cost of transporting to the nearest delivery point, is that it allows the use of the published basis differences of the ten designated spot cotton markets. The ten spot markets of Norfolk, Augusta, Savannah, Montgomery, Memphis, Little Rock, Dallas, Houston, Galveston and New Orleans have been designated by the Secretary of Agriculture as those from which quotations for the various grades and staples of cotton are taken daily and averaged, these averages being used in determining the differences for grade and staple allowed in deliveries on futures contracts. Thus the element of individual or localized opinion on basis valuations is eliminated.

Furthermore, the functioning of the normal cotton market is such that the merchant can always dispose of his tenderable cotton against a futures contract. He has, in his own hands, the control of this matter and does not

have to wait until his cotton is sold, lot by lot of even running character, to a variety of buyers and with the delays caused by the exigencies of trade. If the merchant already has the necessary short futures open, this method of valuation amounts to a closing of his position in respect of the tenderable cotton and the relative open short futures. If the necessary short futures are not in his position, these futures may be contracted for promptly and at the price quoted in the market selected for the transaction. Naturally, there exists the possibility of certain of the cotton considered by the merchant as tenderable being rejected on tender. However, this possibility exists in other methods of cotton inventory disposal and other methods of valuation contain the same element of risk.

The valuation on the balance sheet and in the income account of the effect of the merchant's obligations on open transactions is effected by applying a theoretical close-out to all the open items as of the balance sheet date. Thus all contracts which have been undertaken on a given futures month, for example, December, are valued by calculating the difference, existing at the date of the balance sheet, between the quoted price of December futures at the date of fixation of the contract and at the balance sheet date.

Thus a fixed forward sale of 1,000 bales based on December may have been fixed on July 6 when the December futures contract was quoted at 13.15¢ per pound and on July 31 the price of the December futures contract may be 12.52¢ per pound.

The calculation would appear as follows:

December price at fixation date	13.15¢
December price at July 31st....	12.52
Difference	.63¢

1,000 bales of 500 pounds weight at .63¢ per pound gives a total value of $3,150.00 for inclusion in the balance sheet.

The valuation of $3,150.00 developed in the above calculation will be included in the balance sheet under the heading of "market differences on open transactions" and will be shown on the asset side. If the December futures contract at July 31st showed a greater value than at the fixation date, then the calculation of the difference would be included on the liability side of the balance sheet under the above noted heading.

In the cotton merchant's position, the above fixed forward sale will be part of the short side, and will be serving to counterbalance one or more of the items of the long side of the position. Just as a decline in market price shows a valuation, which for the short side of the position is taken into account as an asset, so on the long side of the position, a decline in market price develops a valuation to be taken into account as a liability.

All elements of the merchant's position are valued in accordance with the above principles and are included in the balance sheet under the classification of "market differences on open transactions", being taken into account on the asset or liability side of the balance sheet as the case may be.

It will be observed that in the valuation of the cotton merchant's obligations on open transactions, the fluctuation of futures' prices has been considered, but no accounting has been made for the effect of basis variations.

Not only fixed forward sales, but also fixed forward purchases, and both sales and purchases which are unfixed, have the element of basis present, that is the difference between the final price of the spot cotton and the futures upon which the contract is based.

In general, in considering valuations for the purpose of placing the cotton merchant's balance sheet on a liquidating basis, effect is given to those items over which the merchant has undisputed and immediate control. Thus, the liquidation of the merchant's tenderable inventory may be controlled promptly by delivery on futures contracts and the balancing of fixed forward sales and fixed forward purchases has been undertaken through the opening of long and short hedges. Even in the case of an unbalanced position with respect to "market" risks, as distinct from "basis" risks, no circumstance exists, beyond a complete breakdown of the recognized cotton exchanges, whereby a merchant may not completely and promptly mature the valuation of his market position. A breakdown of commodity exchanges would introduce questions of valuation that are certainly not within the scope of these observations, nor within the considerations involved in discussing the balance sheet of a going concern.

Basis risks are not under the control of the cotton merchant, those are the risks he will have to encounter always.

However, if at the date of the balance sheet, it is found that the basis, on which the merchant has sold cotton, is materially lower than that at which, according to the most reliable evidence, he could purchase the cotton for shipment, proper comment should be made as to the possibility of loss. Similarly, appropriate comment may be made, if apparent basis profits are found.

Basis is recognized in the valuation of the inventory of cotton on hand, but then prompt liquidation is possible of control through delivery on futures contracts.

It is recognized that the above described methods of valuation do not necessarily produce a statement in terms of cost or market, whichever is lower.

The typical income account as shown earlier in these comments requires little explanation. In general, however, it is felt that the statement, although in the form in general use, is not entirely satisfactory as a true guide to the results of the merchant's operations. If, in course of time, it is possible to interest cotton merchants in a more detailed study of their accounts and accounting systems, more illuminating statements of operations may be prepared. Detailed records for the accumulation of the costs of services with respect to particular shipments, and the final outturn of these shipments, both with respect to customer and point of destination should provide valuable information. Other fields of enquiry include those of ascertainment of the true costs of purchasing, storing and handling cotton. As it is, the cotton merchant's statement shows items of general operating costs and costs of buying and shipping cotton in total classifications, irrespective of whether the cotton be bought in the interior or at a port compress and with indifference as to whether the cotton be delivered to eastern mills or to European ports. Thus, no definite check is had, through

(*Continued on page* 23)

Revised Requirements for Listing Investment Trust Securities on the New York Stock Exchange

On June 6, 1929, the New York Stock Exchange issued Tentative Special Requirements for Listing Investment Trust Securities. It was stated that "as experience with conditions gained through actual application progresses, the right is reserved to alter or amend these requirements."

The Committee on Stock List which has been giving continuous study to this subject since the tentative requirements were promulgated, has considered twenty listing applications and has had discussions with Investment Trust managers and accountants. As a result of this consideration, the Committee has now issued revised listing requirements for Investment Trust securities. It is expected that these revised requirements will have an important effect upon Investment Trust accounting and reports. Investment Trusts whose securities are not listed on the New York Stock Exchange will doubtless adopt many of the Committee's recommendations as representing the conclusions of an authoritative body based upon extended experience and research.

The requirements are confined to Investment Trusts of the general or management type which is the only type that may be listed on the New York Stock Exchange at the present time. The Exchange has recently ruled that members may distribute securities of fixed Investment Trusts only if the Trusts comply with certain rules but the securities of such Trusts can not be listed and the rules of the Exchange regarding the distribution of such securities are not discussed here.

The principal additions to the tentative listing requirements as set forth in the revised requirements are summarized below:

1. The Committee favors the elimination from the income account of all profits or losses on security transactions and crediting or debiting them either to a properly designated reserve (which is preferred) or else to a special surplus account segregated from earned surplus. If the reserve is established and a debit balance occurs therein it should be shown as a deduction from earned surplus. This reserve or special surplus account should not be regarded as available for current dividends and when utilized as a source of special dividend should carry with it a clear indication of its character.

2. In cases where profit on sales of securities is treated as a part of the income, losses on sale of securities must be treated as part of the deductions from income. If reserves have been established against such losses, the full realized losses should first be included in the income account and any utilization of such reserves should be treated thereafter as a transfer from reserves to the credit of income account.

3. In computing realized profits or losses on the sales of securities, the method of computing the cost of securities sold upon the basis of

their average cost appears to be the only one which does not result in a distortion of the income account.* The method of computing costs of securities sold must be described in all financial statements presented and attention called to any changes in accounting methods during the period.

4. Any profit arising out of the reacquisition of a company's own preferred or common stock at less than its par or stated value or arising out of the resale of such reacquired stock at a price higher than that at which it was reacquired, must be shown as an item of capital or capital surplus ,and in no case as a part of earnings or of earned surplus. Profits arising out of the reacquisition of its own bonds by a company may be used (a) to diminish any unamortized bond discount and expense (b) credited to earned surplus direct and not through income account, or (c) credited direct to capital surplus at the option of the company.

5. There should be added to the income account in the case of investment trusts which eliminate from the income account realized trading gains and losses, a footnote showing any change which has taken place in the reserve or special surplus account through which these trading gains or losses are booked.

6. In the balance sheet a clear distinction must be made between capital surplus and earned surplus. If reserves have been created the designation of these reserves must be so clear that there can be no doubt of their nature and purpose. Proper reference in a footnote should be made to any reserves set up against all or any part of any unrealized losses.

7. A new paragraph headed "Analytical Statements" has been added, which is quoted in full:

> There should be included in the report an analysis of the change in position during the period, showing the net improvement or impairment in position for the period, including unrealized gains and losses, such change to be shown after dividends and without taking into account capital transactions. The net improvement or impairment in question should be shown in the aggregate, and per share for each class of stock outstanding.
>
> The actual dividend per share paid on each class of stock outstanding should be shown in connection with this analysis.
>
> There should appear in the report an analysis of the cover in back of all capital obligations; for the purpose of this analysis, the portfolio should be adjusted to the market value, including in this adjustment the portfolio of any unconsolidated and subsidiary investment Trust as though it had been fully consolidated. This should show as of the beginning and end of the period under review the following items, together with such changes in them as have taken place:
>
> (1) Assets behind outstanding bonds,
>
> (2) Assets behind outstanding preferred stocks,
>
> (3) Assets behind outstanding common stock,
>
> in each case expressed in dollars per unit of the security in question.
>
> While this analysis may be shown in any suitable manner, the Committee is prepared to furnish forms which it regards as appropriate.

8. The paragraph with reference to Auditors' Certificate has been re-

* *This method has not been approved by the Treasury Department for income tax purposes. The Treasury still holds that the taxpayer must follow the method of first in, first out, or identified certificates, in computing profit and loss on sale of securities for income tax purposes.*

vised so as to read that the certificate of a public accountant which must be appended to all financial statements must cover "all financial and analytical statements submitted."

9. A new paragraph has been added with reference to the purchase of own common stock which is quoted in full:

> The applicant shall not purchase or otherwise acquire for its own account, or indirectly through a subsidiary, shares of its common stock, however designated, otherwise than under exceptional and special circumstances. In case any such purchase is made, the applicant shall publish in its annual report the number of shares purchased and the price paid for such shares. In case the applicant purchases any of its own common stock, it shall submit promptly to the Committee on Stock List all relevant facts in connection therewith, and upon request of the Committee it shall take such steps as the Committee deems necessary to make such reacquired shares unavailable for trading without further application. Permission to dispose of such reacquired shares will be granted only on condition that the sale price of such shares shall be fully shown in the annual report.

10. Under the paragraph headed "Special Agreement" a very important paragraph has been added, reading as follows:

> This agreement must further provide that no dividends will be paid upon common stock unless net earnings excluding net realized trading losses, are at least sufficient to cover them.

In addition to the formal listing requirements the New York Stock Exchange has issued a statement containing general observations regarding Investment Trust policies, which are stated to represent merely the existing preferences of the Committee and are of too tentative a nature to incorporate in the listing requirements. The more important of these recommendations follow:

I. Reacquisition of Outstanding Securities

In the case of companies having prior securities outstanding the reacquisition of common shares (except for the purpose of prompt re-issue for the acquisition of assets) would appear in most cases to be open to the objection that it would tend to reduce the equity in back of prior securities. The reacquisition of bonds appears in general unobjectionable. The reacquisition of common shares where there are no prior securities or the reacquisition of preferred shares appears unobjectionable when acquired

(a) for retirement
(b) for resale to management under proper provisions
(c) for re-issue in connection with plans of consolidation or merger,

provided that in each instance the purchase price of common stock is not in excess of its asset value and the purchase of preferred stock is at a fair price and does not impair substantially the equity behind any outstanding senior securities.

II. Acquisition of Stock of Other Investment Trusts

The acquisition of properly protected preferred stocks of other Investment Trusts is not objectionable but the acquisition of substantial amounts of common shares should in general be discouraged as containing the possibility of unsound pyramiding and as involving the delegation to others of a responsibility for the investment of funds which the management had assumed in connection with the operations of their own company.

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The New York Office on Historic Ground

By Richard E. Nevius.
(New York Office)

On May 2, 1931 members of the downtown staff in New York reported at the firm's new office located in the Stone & Webster Building at 90 Broad Street. The new location is but a stone's throw from the country's financial center at Broad and Wall Streets. On the four corners of that junction point are located the United States Sub-Treasury Building, the New York Stock Exchange, the office of J. P. Morgan & Company and the Bankers Trust Company.

The new quarters, slightly larger in area and of an improved layout, permit of accommodating the entire staff on one floor. In this respect the new offices are a decided improvement over the quarters at 110 William Street which were occupied for nine years. When the New York office first located there, we occupied one floor but the growth of our practice had made it necessary after a time to use a portion of another floor as well.

The recently completed Stone & Webster Building covers the entire block-front on lower Broad Street, between Stone and Bridge Streets. Its 25 stories raise its roof well above nearby buildings and afford the occupants of its upper floors an uninterrupted view to the south and east. Bounded by streets on three sides and on the fourth by a low building owned by Stone & Webster Building, Inc., its tenants are assured permanent access to daylight, while its solid construction will permit its height to be doubled without inconvenience to its occupants. Construction records in New York present an amazing series of continual time reductions, but it is interesting to note that a new record was established by the completion of this building in ten and one-half months after the first excavation.

Bit by bit the newer buildings of lower Manhattan have been reaching out from Wall Street toward the waterfront, each new arrival edging its way into the skyline, until they are now sinking their foundations into the same soil that was used by Manhattan's earliest builders, three hundred years ago. New Yorkers are hardened to progress, the marvels of the city's development are forever being replaced by newer marvels, today's miracles, by the greater ones of tomorrow. To recite the changes that have become the history of downtown New York would be to tell an old story to ears that are already fatigued with superlatives. To say that a lot which now sells for millions was conveyed in 1643 for $9.50 is to repeat a fact with which every New Yorker is familiar. It would be amusing, however, could we experiment with time and somehow transplant a worthy and corpulent burgher from New Amsterdam, his stout form outfitted in tight waistcoat and bagging breeches, lean him against a doorway in his favorite Brugh Straat, now Stone Street, and allow him to survey the wonders that 300 years have brought to his front door. It would take, we imagine, a series of exceedingly deliberate puffs on his long pipe before his amazement could find its way into sufficiently conservative expression.

Nor would our own bewilderment be much less, could we return with

him to the shelter of his own century and to the settlement of New Amsterdam.

Lower Manhattan has had a varied geographical career and has expanded horizontally as well as vertically. When the first Dutch traders set up their huts on the land of the Manhattoes in 1610, the eastern water line was the present course of Pearl Street, which owes its meandering route to the civic activities of the colony's cows. What is now Broad Street began as an inlet from the bay, and drained the marshes and ponds above Beaver Street. Canal-minded Hollanders supplied dykes for a distance of twelve feet on each side, named the resulting canal the Heere Gracht and made it the main artery of the settlement. The canal was tidal as far north as Exchange Place and, in spite of the efforts of the colonists to deepen and improve it, gave rise to an annoying stench at low tide. In 1663 a lock was constructed to hold more water in the canal and every resident was required to dig out and remove two feet of mud. Whether or not the result was successful was never disclosed, but with the advent of English rule, the doom of the canal was sealed. Filled in and paved, it became the Broad Street of modern times, although the old canal bed is still in use as a sewer and drain for one of New York's most crowded regions.

There were numerous foot bridges over the Heere Gracht in the early days, but only one wide enough for "cattell and wagons." This was at Hoogh Straat, now Bridge Street, and must have been very convenient for the early occupants of 90 Broad Street. Boats landed their cargoes at this bridge and it soon became a trading center and the site of the weekly market, which was held between eleven and twelve on Friday mornings.

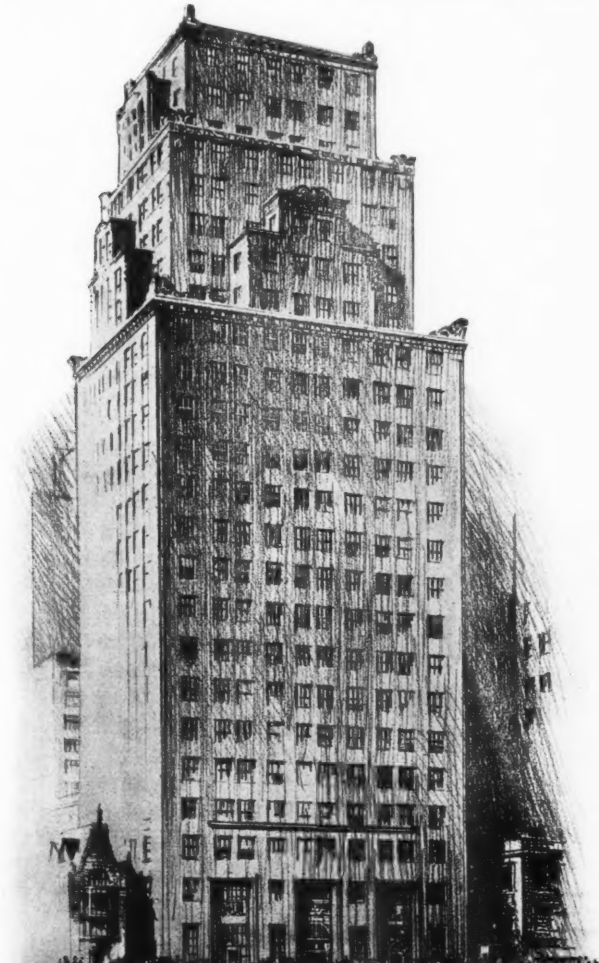
It must have been a colorful sight, this first market in New York. To it came Indians bartering tobacco, maize and oysters for rum and the other luxuries of civilization. Farmers from the outlying districts north of Wall Street brought in their produce in exchange for food, clothing and goods imported on trading vessels. The plentiful supply of beavers in the vicinity made their pelts a common medium of exchange.

Flanking the canal and its side streets were the principal shops and dwellings of the community. The houses were one-story affairs, of stone and wood, later faced with decorative designs in brick. Commodious lofts were topped by thatched roofs with high gables slanting at sharp angles, resulting in a skyline which must have been fully as impressive as that formed by the cloud-piercing towers of today. The peak of each roof had its weathercock, upon whose veracity the inhabitants placed great reliance. Irving tells us that even more faith was placed on the weathercock perched on the governor's roof, because every morning a trusty servant was required to climb up and turn it in the direction of the wind. Numerous diamond-paned windows furnished ample light to the interiors, whose white-washed walls and simple furnishings testified to the characteristic neatness of the Dutch occupants. White sand, which covered the floors, was swept into swirling designs by the housewife's broom.

Dutch doors, divided laterally into two sections, made it possible for the burgher to lean against the lower half and enjoy his evening pipe in the open

air. Each seventh house was required to provide a lantern over its high stoop to serve as a street lamp.

lived Burgomaster Olof Stevenson Cortlandt and here also was the home of Abraham Jansen, the carpenter.



STONE & WEBSTER BUILDING, 90 BROAD STREET, NEW YORK

Five houses filled the block between Stone and Bridge Streets, where 90 Broad Street is now located. Here Housewives stopped here daily to buy silks, galloons, and laces in the shop of Simon Jansen Romeyn.

Around the south corner on Bridge Street was the brewery of the West India Company; across Broad Street was the baker's shop and the home of Tuenis Cray, official measurer of apples and onions.

Stone Street, deriving its name from the stone pavement laid there about 1660, was the finest residential street of the town. At its head was the tavern kept by Lucas Dircksen. Beyond this was the home of Frederick Philipse, the wealthiest man in the community. On this street in 1642, Adam Roelantsen opened a school, although there had been an earlier private school for which the tuition was two beavers a year. Here also lived Jacob Sheendam, whose appreciation of the locality is voiced in the following bit of lyricism:

"This is the land where milk and honey flow,
Where healing plants as thick as thistles grow.
The place where flowers on Aaron's rod do blow,
This, this is Eden."

Next above Stone Street is Petticoat Lane, the lost thoroughfare which once stretched from Broad Street past the fort to what is now Battery Place. Its present name is Marketfield Street and its career is cut short by the Produce Exchange.

With the growth of trade, the old market at the bridge moved into a covered building at the corner of Pearl Street. It later became a coffee house and the first theatre in New York.

Across the street, at the corner of Pearl and Broad Streets, Etienne De Lancey built in 1719 one of the finest mansions in the city. Samuel Fraunces, a Frenchman from the West Indies, bought it in 1762 and there set up the "Queen's Head" Tavern. This famous tavern, the scene of Washington's farewell to his officers, has been restored in recent years and still stands as one of the oldest landmarks in the city.

Always keeping pace with changing conditions, Broad Street has supplanted its markets with stock exchanges and its residences with skyscrapers. It is still in a process of continual change, but its importance as a center of trade has never waned. Thousands of workers, hurrying home from its lofty office buildings, traverse the same street about which, in the days of Father Knickerbocker, a poet could say, "This, this is Eden."

Origin of Word "Assets."

When account is made of a man's whole financial position he is found to have debts, and he has or ought to have, *enough* to meet them. In the old Norman French formerly used by English lawyers this "enough," set down on the credit side, was represented by the word "assetz," which in modern French has become "assez." From this "assetz" comes the English "assets." From this derivation two interesting points emerge. First, the spelling "assets," which appears as an English word early in the sixteenth century, indicates that at that time the Z in the French word, which is now silent, must have been pronounced. Secondly, since "assets" is not plural, there is not, properly speaking, such a word as "asset."—*D. M. M. M.*

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. and Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvements; to encourage and maintain a proper spirit of cooperation and interest and to help in the solution of common problems.

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Robert Shaw Montgomery

1905-1931

Robert Shaw Montgomery, oldest son of Colonel Montgomery of our firm, became a member of the staff at our Boston Office in 1927. During a preceding summer, while a student at Princeton University, he had been a junior assistant on our New York Office staff. Early in 1931 he was transferred to our Washington Office where he did excellent work until his sudden death on May 17, 1931.

Colonel Montgomery has prepared a statement so that those who did not know Bob may make a more accurate appraisal of his tragic end than if their judgment were founded solely on newspaper rumors, most of which were wholly false. A copy of this statement is available to any member of our organization on request therefor.

Next Season's Merchandise

Under the above caption, the Robert Morris Associates published a brief article reading as follows:

For many years it has been the custom in several lines of industry to eliminate from the balance sheet on statement date, merchandise on hand but unpaid for, purchased and intended for next season's business. This custom has been particularly prevalent among shoe manufacturers and dry goods jobbers. Before credit men were sufficiently familiar with the practices in these industries to require information about such merchandise holdings, the complete facts were not always revealed. Now that the custom of handling new season's merchandise has become so well understood, credit men have required full particulars, and the information is furnished in some instances in a footnote. Title to such merchandise unquestionably rests with the purchaser of the goods who has them in his possession, and who is, or at least should be, paying insurance on them. On the sellers' balance sheet they appear as accounts receivable. A company's object in having the figures made up in this way is to have the balance sheet show a smaller debt and a better current ratio, and to attain this end they overlook the fact that it tends to make the credit man feel that his customer is attempting to influence his opinion by an unduly favorable arrangement of the financial facts. If the merchandise and the liability therefor were included among the assets and liabilities, it would create greater confidence.

A practice in which the principle is somewhat similar to the above is found in the textile industry. Mills frequently buy machinery from the manufacturer, giving notes in payment running over a period of years. The manufacturer retains a lien on the machinery but it is installed in the mill, is in active use, and to all intents and purposes is the mill's property. The mill frequently, however, does not include in its balance sheet either the machinery as an asset or the offsetting liability for notes payable, but reports them in a footnote. The pledged machinery and the secured liability unquestionably belong in the balance sheet. Omission so to include them creates the same unfavorable impression as in the case of the next season's merchandise of the shoe manufacturer or dry goods jobber.

Now the question is how can the de ired result best be brought about? Our suggestion would be to have the accountant or the bank, or maybe both, show the owners of the business how their balance sheet looks as it is set up on the bank's comparative statement form where the item is included on both sides. As it is now, the borrower brings the statement to his bank and has a very distinct impression that it is a good showing, properly proportioned, etc., whereas the bank analysis indicates an entirely different picture. There must be one right way of showing such an item and this we believe to be the method just indicated, therefore, the accountants and the banks should work toward the goal of showing the situation uniformly and in the right way.

For many years our firm has never knowingly certified a balance sheet which omitted full disclosure of the two items which are discussed above.

Judicial Mention

The courts have repeatedly quoted from Colonel Montgomery's works on Auditing Theory and Practice and Income Tax Procedure in citing authority for a given principle or practice. A recent decision by the United States Circuit Court of Appeals for the Second Circuit in *Auto Sales Corporation v. Commissioner* contained references to writings of both Mr. Lybrand and Mr. Staub. In Judge Mack's opinion, he referred to Mr. Lybrand's paper on "The Accounting of Industrial Enterprises" read before the 1908 convention of the American Association of Public Accountants (published in Volume VII of the *Journal of Accountancy*) and to Mr. Staub's lecture on "Consolidated Returns" delivered at Columbia University (published in "The Federal Income Tax" by the Columbia University Press).

Notes

On April 9th and 23rd a committee of the Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants met with the Philadelphia Chapter of the Robert Morris Associates, to discuss questions of common interest pertaining to financial statements used for credit purposes.

Mr. Russell of our firm was a member of the committee representing the Pennsylvania Institute and participated in the answering of questions raised by members of the Robert Morris Associates.

Mr. William F. Marsh has been appointed Convention Committee Chairman of the Twelfth Annual Cost Conference of the National Association of Cost Accountants, to be held in Pittsburgh, Pennsylvania, during June.

Mr. A. Karl Fischer has been elected a director of the Philadelphia Chapter of the Pennsylvania Institute of Certified Public Accountants.

At the annual meeting of the New York State Society of Certified Public Accountants, held May 11, 1931, Mr. Staub and Mr. Sinclair were reelected First Vice-President and Treasurer, respectively, for the ensuing year.

Be Careful!

A moral for one who misplaces decimal points might well be drawn from the following dispatch which appeared some time since in the newspapers under a Hudson, Wisconsin, heading:

> An ordinary fly, untamed, unidentified, and probably totally ignorant of modern bookkeeping methods, succeeded in juggling the figures of City Clerk Hosford to the extent that Hudson lost approximately 150 feet of real estate.
>
> For several years one lot in the town was shown on the assessors record to have a depth of only 16.5 feet. Mr. Hosford pondered on that and finally decided to check back the records. Year after year, volume after volume, the lot retained its brevity—and then suddenly it was lengthened to 165 feet.
>
> Mr. Hosford looked more closely at the figures to ascertain why the change had occurred. They bore unmistakable evidence that the decimal point had been meticulously placed by a fly. An unobserving clerk had for years faithfully copied the fly speck.

This story may well be matched by the tale told the editor years ago by a Civil War veteran who was then using the bookkeeper's pen instead of the sword of war days. The tale—told in all solemnity—was that a trial balance difference of 3 cents defied detection. Checking and rechecking, verification again and again of footings and postings, all were of no avail. Then the bookkeeper happened to brush his hand over a figure and his startled gaze saw a figure 4 change to a figure 1. The crooked leg of a fly had been lying across the figure 1 and thus made it appear to be a figure 4!

Some Observations on the Business and Accounts of a Cotton Merchant

(*Continued from page* 13)

the operating accounts, on the adequacy of the merchant's charges against the buyer of his cotton, for the various costs of service rendered to the buyer in holding and delivering the cotton to him.

There are many other matters, in connection with the accounts of a cotton merchant, which are worthy of consideration, but which cannot be detailed within the limits of these observations. Such matters include the more intimate details of cotton inventory valuations, problems arising in

valuations of cotton in foreign ports, valuations of such open contracts as are termed "conversion contracts", and explanations of principles involved in valuations of open contracts where the covering hedges have been transferred from one futures month to another.

Income Tax Ruling Regarding Futures, Etc.

Finally, one must not overlook the ruling emanating from the Bureau of Internal Revenue under Appeals and Review Memorandum 135. This memorandum acknowledges, for the purpose of determining taxable income, the right of dealers in cotton, to incorporate in their balance sheets such open "future" contracts to which they are parties as are "hedges" against actual "spot" or cash transactions; provided that no purely speculative transactions in "futures" not offset by actual "spot" or cash transactions may be so included or taken into account in any manner until such transactions are actually closed by liquidation. Thus, the cotton merchant with his market position theoretically in balance may include all items, but if he is long or short of the market, the amount which is speculative must be excluded. But, what portion of the merchant's position is it, that creates the long or the short position? Is one merchant with an inventory of 100 bales of cotton on hand, purchased at a fixed price on October, and 100 bales of January futures in a balanced position, and is another merchant with a similar inventory and 100 bales of fixed forward sales based on December also in a balanced position, and is a third merchant with nothing but a similar inventory in his position, in a non-speculative position?

Revised Requirements for Listing Investment Trust Securities on the New York Stock Exchange

(*Continued from page* 16)

III. Dividend Policies

The following statement of the Committee is quoted in full:

The Committee on Stock List considers it unwise for Investment Trusts to declare dividends on their common stock unless the total revenue of the corporation from the date of its organization to the date of such dividend declaration has been in excess of its expenses and dividends paid during such period by an amount sufficient to cover the dividend in question and also any net realized loss together with provision for any net unrealized loss accrued during the same period.

However, instances have been drawn to the attention of this Committee which suggest that a strict interpretation of this view might at times work a real and unjustifiable hardship on investors. Accordingly, the Committee at this time desires merely to express the view that investment trusts should not pay regular dividends on their common stock unless the total revenue of the corporation, exclusive of any net realized losses, from the date of its organization to the date of such dividend declaration, has been in excess of its expenses and dividends paid during such period by an amount sufficient to cover the dividend in question. Any net realized or unrealized loss may be disregarded for the purpose of this calculation, provided that a notice, conforming to the Agreements of the Stock Exchange in this respect, is sent to the stockholders with the dividend.

IV. Directorates

It is recommended that Investment Trusts have independent directors on the Board to avoid any suspicion of questionable transactions existing between a Trust and its banking sponsors.